

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
KAROLIGHT, LTD.	:	DETERMINATION
	:	DTA NO. 802708
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period June 1, 1981	:	
through February 29, 1984.	:	

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Petitioner, Karolight, Ltd., Attn: Karol Fisher, New York Karol, Inc., 179-10 Union Turnpike, Flushing, New York 11366, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1981 through February 29, 1984.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on December 15, 1992 at 1:15 P.M., with all briefs to be submitted by July 12, 1993.<sup>1</sup> The Division of Taxation, appearing by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel), submitted its brief on May 17, 1993. Petitioner, appearing by its president, Karol Fisher, submitted its brief on July 10, 1993.

ISSUE

Whether petitioner has established that the Division of Taxation improperly subjected to tax certain receipts claimed by petitioner to be nontaxable receipts arising from sales made outside of New York State.

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<sup>1</sup>A somewhat extended period of time was allowed post-hearing, at the parties' request, to afford the Division of Taxation an opportunity to review the volume of documentation first submitted by petitioner at the hearing.

### FINDINGS OF FACT

Petitioner, Karolight, Ltd. ("Karolight"), is a New York corporation which was engaged, during the period at issue, in the sale of beauty salon services, hair styling/coloring products including "Karolight Kits", and various items of clothing including jeans, sweaters, blouses, belts and the like. Karolight's president, sole shareholder and driving force is one Karol Fisher. Karol Fisher is a well-known, entrepreneurial hair stylist. He has appeared on numerous nationally-syndicated television programs as an expert on matters of hair coloring and lightening, both in the context of original coloring and lightening as well as in repairing poorly-crafted coloring jobs.

During the period in question, Karolight operated two beauty salons located, respectively, in Manhattan (on 66th Street between Madison and Fifth Avenues) and in Queens, New York. Mr. Fisher, a tool and die maker by original training, perfected a hair coloring system using his own specially designed combs and clips. His system functions such that hair coloring or lightening can be accomplished in a controlled manner so as to minimize damage to the hair and achieve very specific coloring or lightening results. These combs and clips, packaged in various combinations, are generically called the "Karolight Kit". In turn, it is Karolight's sales of Karolight Kits and related coloring and lightening supplies during the period in question which is the principal matter at issue herein.

On or about May 17, 1984, the Division of Taxation ("Division") advised petitioner that its sales tax returns would be subjected to a field audit. It is undisputed that the Division issued to petitioner an audit appointment letter scheduling such audit and requesting that all of petitioner's books and records pertaining to its sales tax liability for the period June 1, 1981 through February 29, 1984 be available for review. According to the audit report, and to the auditor's testimony, those records made available for review consisted of sales tax returns and related worksheets, Federal and New York State corporation income tax returns and franchise tax reports, sales journals, cash receipts journals, and monthly bank statements. The audit report lists those records not made available as including petitioner's general ledger, sales

invoices, cash register tapes, and documentation (including exemption certificates) substantiating claimed nontaxable resale, out-of-state and foreign diplomatic sales. The auditor's review of petitioner's cash receipts journal and sales journal revealed that Karolight accounted for receipts under five categories, to wit, "Karolight Kits", "beauty salon", "jeans", "resale", and "other".

The auditor visited petitioner's Queens, New York premises on or about August 17, 1984. Mr. Fisher described such premises as being approximately 18 feet by 70 feet in dimension. Approximately two-thirds of such store space housed display racks holding jeans, sweaters and other clothing items, with the balance of the store space housing the beauty salon. The beauty salon was located in the rear of the premises and included three cutting/styling chairs.

One of the auditor's first steps was to attempt to reconcile Karolight's Federal corporation income tax returns with its cash receipts journal and its sales tax returns. While the former two records did reconcile with each other, a substantial difference existed between such two records and the amounts of sales reported on Karolight's sales tax returns. The auditor was advised that the difference was due to the fact that gross sales were not reported on Karolight's sales tax returns, but rather that only taxable sales were reported thereon. As noted, petitioner accounted for receipts under five categories. The auditor was advised that the "other" category represented loans to the corporation, and that the "beauty salon" and "jeans" categories represented taxable sales the amounts of which were split evenly between beauty salon sales (taxable at 4 percent) and clothing sales (taxable at  $8\frac{1}{4}$  percent).<sup>2</sup> The remaining categories, "Karolight Kits" and "resale", were treated as nontaxable sales by petitioner. Finally, the auditor was advised that a "small percentage" of Karolight Kits were sold in New York. These sales were allegedly included and accounted for as taxable sales, at the rate of  $8\frac{1}{4}$  percent, under the "jeans" category (petitioner noted, in explanation, that tax would be due at the same tax rate

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<sup>2</sup>For the earliest sales tax quarterly period at issue herein (6/1/81 through 8/31/81), the sales tax rate was 8 percent. For the balance of the audit period, the rate increased to  $8\frac{1}{4}$  percent.

on either of such items [jeans or Karolight Kits], allegedly leaving the category under which they were accounted for of no consequence).

Petitioner advised the auditor that exemption under the "resale" category involved sales of clothing items for resale and, to a lesser degree, sales of clothing to foreign diplomatic personnel for shipment overseas. In turn, exemption under the "Karolight Kit" category was claimed

on the basis that such sales were made and shipped to purchasers located outside of New York State.

The auditor requested shipping invoices to substantiate the claimed out-of-state shipments of Karolight Kits, resale certificates with respect to the claimed sales of clothing for resale, and exemption certificates with respect to clothing sales allegedly made to diplomatic personnel. The auditor accepted without challenge petitioner's claim that the "other" category represented loans to the corporation which would have no impact or effect for sales tax purposes.

The auditor testified that petitioner was unable to provide substantiation of nontaxability as requested. The auditor specifically noted that Mr. Fisher made at least three visits to the auditor's offices, but was unable to provide the documents requested as substantiation. The auditor admitted that petitioner did present some United Parcel Service ("UPS") forms indicating out-of-state shipments of merchandise; however, he noted that such forms were few in number and pertained to shipments made after the audit period in question. In addition, the auditor noted that there were no sales invoices presented to "match up" to the UPS forms, therefore leaving the auditor with no idea as to how much merchandise was sold to any particular customer. Based on petitioner's inability to provide substantiation as requested, the auditor determined tax due on additional taxable sales (i.e., disallowed nontaxable sales). The auditor calculated such additional taxable sales as gross sales (per books) less loans (per books) and less taxable sales reported (per sales tax returns). This calculation resulted in additional

taxable sales in the amount of \$149,402.00, with tax due thereon in the amount of \$12,369.58.

In addition to the foregoing, the auditor also requested bills (invoices) with respect to petitioner's fixed asset acquisitions during the audit period. The auditor's review thereof revealed \$23,489.00 in fixed asset acquisitions. However, only one invoice submitted showed payment of tax (involving the acquisition of an asset valued at \$4,600.00), with the balance of fixed asset acquisitions (totalling \$18,889.00) unsubstantiated by invoices showing that tax had been paid. Accordingly, the auditor calculated and assessed use tax due in the amount of \$1,558.35 on such fixed asset acquisitions.

On July 20, 1985, the Division issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due assessing sales and use taxes for the period June 1, 1981 through February 29, 1984 in the amount of \$13,927.93, plus interest. This notice was based on the audit steps and calculations described hereinabove.<sup>3</sup>

Petitioner, in turn, challenged the results of the audit arguing that all of its taxable sales had been reported on timely filed sales tax returns, and that all tax liability shown thereon was remitted in a timely fashion.<sup>4</sup>

In addition to providing styling services at petitioner's two beauty salons, Karol Fisher also conducted numerous seminars in different

states around the country in promotion of the Karolight Kit, and was featured in numerous fashion magazine articles. Petitioner maintains that these seminars, magazine articles and Mr. Fisher's approximately 20 promotional appearances on nationally-syndicated television shows during the period 1980 through 1985, generated a large volume of sales of Karolight

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<sup>3</sup>Validated consents included in the record allowed assessment for the period June 1, 1981 through August 31, 1982 to be made any time on or before September 20, 1985.

<sup>4</sup>Procedural issues in petitioner's case were challenged and, ultimately, dealt with in prior decisions issued by the Tax Appeals Tribunal (see, Matter of Karolight, Ltd., Tax Appeals Tribunal, February 8, 1990 and July 30, 1992).

Kits. As noted, petitioner originally claimed that some of its clothing sales were nontaxable as sales for resale and sales to diplomatic personnel for export overseas. However, petitioner restated its argument at hearing and by brief. Petitioner now claims that only a very small portion of its claimed nontaxable sales were clothing sales, and that "98 percent" of its nontaxable sales were in fact sales of Karolight Kits shipped outside of New York State to professional hair stylists, beauty salons and vocational educational institutions throughout the country. Mr. Fisher acknowledged that he conducted seminars and appeared on television shows in New York, and made some Karolight Kit sales in New York (see Finding of Fact "5"), but claimed such sales to be few in number due to intense competition from larger hair care and cosmetics firms.

Petitioner could not specify the precise number of Karolight Kits sold during the audit period, but estimated the same to be in the thousands. In the same manner, petitioner was unable to specify a set price for the Karolight Kit, noting that the kit price varied depending upon what was included therein (i.e., number of combs, clips and related items per kit). Mr. Fisher testified at one point that the selling price for a kit was probably \$59.90, plus \$2.00 shipping and handling. Documents submitted by petitioner showed that a kit sold for \$24.95 and could be ordered by means of a mailer.

Mr. Fisher testified that he was constantly involved in pushing to achieve sales of Karolight products, and did not formally set up an organized sales invoicing system, lamenting that as a result Karolight missed out on repeat business. Mr. Fisher alleged that Karolight's recordkeeping for out-of-state sales consisted of UPS shipment books. In this regard, Mr. Fisher claimed that all UPS shipping books for the years in issue were brought to the auditor's office for review. Mr. Fisher alleged that all such books for the years in question were thereafter stored in his briefcase, and that his briefcase and the enclosed UPS records for the audit years were stolen during the course of a burglary at petitioner's Queens store premises, and were never recovered. The burglary was reported to the police as occurring on July 20, 1984. The police report lists, as among the items stolen, a "briefcase with documents".

Petitioner presented certain documents including cancelled checks and various travel receipts in support of the claim that Mr. Fisher conducted seminars and lectures in various cities throughout the country. Petitioner also submitted numerous letters from hair care professionals in various parts of the country referencing seminars conducted by Mr. Fisher and indicating interest in obtaining petitioner's products. The Division, in turn, does not dispute that Mr. Fisher conducted such seminars as described.

The Division submitted in evidence five UPS merchandise pickup invoices. All of such invoices are dated after the period in question, save for the first which is dated February 21, 1984. The February 21, 1984 invoice lists two shipments, one to Colorado and one to California, with a \$350.00 declared value of merchandise under the category "beauty supplies". There is no matching sales invoice with respect to this UPS invoice.

Petitioner submitted a one-page workpaper showing tax due in the amount of \$10,938.25 on "resale sales" and "Karolight Kits". Petitioner contrasts this one-page sheet with the Division's summary sheet showing calculation of the Division's assessment of \$13,927.93, claiming that the Division's sheet is in error. Petitioner's calculations are not, however, explained as to source, and the numbers thereon, at least with respect to resale amounts, are different from those shown on the auditor's workpapers (petitioner's figures in this area are in fact higher). There is no explanation furnished to relate petitioner's one-page sheet to petitioner's cash receipts journal or to the auditor's workpapers. In the same manner, petitioner's sheet does not include the calculation of use tax on fixed assets. By contrast, the audit workpaper on which the assessment is calculated reflects all receipts per the categories in petitioner's cash receipts journal, except for the "other" (loans) category. In his calculations, the auditor reduced such receipts by the amount of tax which would be included therein, and calculated tax due on the resultant amount (including beauty salon sales taxable at 4 percent). He then compared the result to the amount of tax paid per petitioner's returns, and assessed the difference as additional tax due (see Finding of Fact "8").

Petitioner claims that all tax due was timely reported and paid, and that, "dollar for

dollar", the amount of exempt sales on which no tax is due has been established. In this regard, petitioner submitted a number of letters consisting of comments from various salon owners and professional hair designers indicating that they would like information regarding petitioner's products and that they would like to purchase Karolight Kits. Petitioner also submitted in evidence a series of file folders holding numerous documents. Some of such documents appear to be order slips or order mailers showing requests for shipment of Karolight Kits to out-of-state purchasers. A few of these documents also include handwritten notations (presumably made by Mr. Fisher) regarding dates of mailing of supplies or kits as ordered. Petitioner also submitted photocopies of envelopes, some of which included handwritten notes regarding Karolight Kits. Some of the documents submitted carried dollar amounts, some are duplicated more than once and mixed in among the documents submitted in the various file folders, some are dated after the period at issue, many are undated, some bear a stamp indicating "1982" or "#82" or "0082" with no other specifics, and some of such forms show on their face a handwritten notation "New York Sales Tax 8¼%".

#### CONCLUSIONS OF LAW

A. In this case, there is no challenge to the adequacy of the Division's request for and review of petitioner's books and records for the audit period. Rather, the Division made such request and reviewed the materials presented by petitioner. In fact, the Division's calculation of tax due is based on petitioner's books and records. More specifically, petitioner reported on its sales and use tax returns only those receipts it considered to be taxable, with the balance of its receipts not reported because petitioner claimed the same to be nontaxable. The Division, in turn, accepted petitioner's gross receipts (sales) per its books, but assessed as taxable the difference between such gross sales (per books) and reported sales (per returns), based on petitioner's inability to present documentation as requested substantiating that such unreported receipts were not taxable as claimed.

B. Petitioner continues to claim nontaxability with regard to the challenged receipts, based on alleged out-of-state sales of Karolight Kits and, to a small degree, on sales of clothing



for resale and/or sales of clothing to diplomats. In fact, petitioner's claim has become, most specifically, that 98 percent of its claimed nontaxable sales represented out-of-state sales of Karolight Kits. Petitioner submitted no evidence or argument regarding use tax assessed with respect to fixed assets. Accordingly, this portion of the assessment (see Finding of Fact "9") is unchallenged and is sustained. Furthermore, since petitioner has submitted no evidence in support of claimed nontaxable clothing sales, and has devoted its argument to the claim of nontaxable Karolight Kit sales, the only real issue is whether and to what extent petitioner has established proper nontaxability of such kit sales.

C. Tax Law § 1132(c) sets forth an initial presumption of taxability with regard to receipts such as those at issue herein, and places the burden of establishing nontaxability upon the person making such claim, i.e., petitioner (Matter of Sunny Vending Co. v. State Tax Commn., 101 AD2d 666, 475 NYS2d 896). To demonstrate that certain sales are not subject to tax, as claimed, petitioner must be able to offer substantiation, in the type of case at hand, specifying the amounts of the particular sales made to the various out-of-state purchasers and confirming that the merchandise sold to such purchasers was shipped (delivered) out of state. Stated simply, petitioner would be expected to present sales invoices or other records of individual sales together with related shipping invoices, log books or the like from parcel delivery services (e.g., United Parcel Service, Federal Express, etc.), commercial carriers, truckers, etc. (see, 20 NYCRR 533.2[b]).

D. On audit, petitioner was unable to furnish direct documentary evidence proving any out-of-state sales of Karolight Kits (nor, for that matter, did petitioner furnish any proof with regard to its then-claimed exempt clothing sales). In this regard, the stated reason for petitioner's inability to provide UPS or other shipping records for the period in question is difficult to accept. Petitioner claims to have submitted such records for the audit period to the auditor, then stored the same in petitioner's president's briefcase which was in turn stolen during a burglary. The theft of the briefcase during a burglary is not disputed. However, the allegations that petitioner's shipping records for the years in question were available initially,

were shown to and reviewed by the auditor, were maintained in the briefcase and ultimately were stolen, contrasted with the general state of petitioner's recordkeeping, lacking invoices of individual sales, and further contrasted with the auditor's testimony that he was never offered any UPS records for the period in question, renders implausible the claim that such UPS records were maintained in any organized fashion or were available to the auditor at any time.

Faced with a complete lack of substantiation, and noting: (a) that petitioner's only two retail stores were located in New York State (Manhattan and Queens); (b) that petitioner's initial claim of nontaxability centered as much if not more on clothing sales than on out-of-state kit sales; (c) that at least two-thirds of petitioner's Queens store was filled with clothing inventory; (d) that petitioner's president presented seminars in New York State and appeared on television shows filmed in New York City; and (e) that petitioner admittedly sold some kits to customers located in New York, the auditor's decision to treat petitioner's non-reported receipts (per books) as entirely subject to sales tax was reasonable (Tax Law § 1132[c]; Matter of Reference Library Guild, Tax Appeals Tribunal, August 4, 1988; Matter of Petak's of New York, Tax Appeals Tribunal, September 9, 1993; cf., Matter of Bernstein on Essex St., Tax Appeals Tribunal, December 3, 1992).

E. Notwithstanding the reasonableness of the auditor's conclusions at the time of audit, a review of all of the evidence, including both the testimony in explanation and the documents offered (apparently for the first time) at hearing, leaves some margin for adjusting the total disallowance of nontaxability determined on audit. In this regard, Mr. Fisher's numerous appearances on nationally-syndicated television shows and at seminars throughout the country promoting petitioner's products, supports a conclusion that petitioner almost inevitably made some sales of kits to customers located outside New York State. Mr. Fisher testified, stridently, both to making such sales and to his claim that all kit sales reflected on petitioner's books and records were out-of-state sales not subject to tax. Mr. Fisher's testimony that Karolight made out-of-state sales was persuasive and, as described, is consistent with the nature and conduct of petitioner's business. This conclusion is strengthened by the file folder submitted in evidence

containing many letters of inquiry from potential customers in many areas of the country seeking information on ordering Karolight products. Unfortunately, however, Mr. Fisher's testimony simply stating that all receipts not included on petitioner's sales tax returns were properly exempt is not, in view of the lack of documents in substantiation thereof, sufficient to support petitioner's position in its entirety. On this score, Mr. Fisher admitted that his primary focus was on promoting the Karolight system and increasing sales, that he was not very organized in establishing an invoicing system, and that this lack of organization cost petitioner in terms of lost repeat sales (see Finding of Fact "14"). Obviously, the problem presented in this case is that notwithstanding the common sense conclusion that petitioner made some out-of-state sales, petitioner is unable to present complete sales invoices and shipping records for the period at issue to substantiate either the specific amount of kit sales made or to establish that the kits were shipped out of New York State and thus were properly treated as not subject to tax.

F. As described, petitioner did submit a relatively large volume of documentary evidence at hearing (see Finding of Fact "18"). Some of this documentation related to petitioner's president's promotional efforts and activities and to the nature of the Karolight Kits and the process of using such kits. Some reflected requests for information from prospective purchasers interested in obtaining kits. Finally, some of such evidence (the four folders comprising Exhibit "10") includes orders for Karolight Kits placed by out-of-state purchasers. The state of petitioner's records in general, including the described documents submitted at hearing, falls far short of establishing petitioner's claim that its only taxable sales were those sales reported, that the balance of petitioner's receipts were not subject to tax and that the assessment should be cancelled. However, some of the documents submitted at hearing contain sufficient information to substantiate purchases of kits and related merchandise shipped to out-of-state purchasers. Such documents, generally described as order forms approximating invoices reflect, inter alia, a description of the purchaser's out-of-state location, the merchandise ordered, the amount paid, the date (falling within the audit period) and, in some instances, handwritten comments

regarding shipping and/or noting that a check in payment accompanied the order. Such sales, totalling \$5,799.42, are accepted as nontaxable sales, and a description of the relevant information for each is set forth in Appendix "A", infra. However, careful and repeated review of the balance of the documentation fails to disclose any additional allowable amounts (due to lack of information [e.g., missing dates, etc.] or due to information proving nontaxability is not warranted [e.g., dates outside the audit period]).

G. The petition of Karolight, Ltd. is granted to the extent indicated in Conclusion of Law "F", but is otherwise denied and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due dated September 20, 1986, reduced in accordance herewith, is sustained.

DATED: Troy, New York  
January 6, 1994

/s/ Dennis M. Galliher  
ADMINISTRATIVE LAW JUDGE

APPENDIX "A"

<u>Date</u>	<u>Name</u>	<u>Address</u>	<u>Folder<sup>5</sup></u>	<u>Amount</u>
12/ /81	The Professionals	Lakewood, CO	B	\$ 169.75
2/8/82	G. Lempers	Hickory Hills, IL	B	51.50
2/ /83	Timm's Place	Ann Arbor, MI	B	129.80
10/28/83	Headliners	Des Moines, IA	B	155.80
9/3/83	Pivot Point	Chicago, IL	B	720.00
6/1/82	BJ's His & Her Beauty Salon	Alliance, NE	B	47.00
12/3/81	Numerical Hair, Inc.	Lakewood, CO	B	41.95
9/16/83	Donnell Wells	Dallas, TX	B	56.94
10/12/83	Operating Room	Maryland Hts., MO	B	189.50
2/7/84	Rags to Riches	Burbank, CA	B	341.70
11/ /81	Roslin Reynolds	Des Moines, IA	B	200.00
3/26/82	Eminently Hair, Inc.	Lakewood, CO	B	83.00
10/ /82	Professional Styling Co.	Tempe, AZ	B	289.65
1/5/82	Hair Artistry	La Mesa, CA	B	41.95
11/16/81	Daviess Co. Voc. Tech. School	Owensboro, KY	B	41.95
5/14/82	Sandra Fries	Nazareth, PA	B	80.00
8/4/83	Pivot Point	Chicago, IL	R	600.00
10/ /81	Martin Berggralli	Lakewood, CO	R	163.65
11/8/81	Hair Designers	Hollywood, MI	R	163.80
12/ /81	Andre of London	Louisville, KY	R	103.90
12/ /81	Tyler Terrace Salon	Sioux City, IA	R	169.80
12/ /81	Eminently Hair, Inc.	Lakewood, CO	R	289.65
2/ /82	Doris' Hair Fashions	Evansville, IN	R	136.85
9/6/83	Angles Hair Design	Lakewood, CO	Y	56.95
1/19/82	Debra White	Morrison, CO	Y	83.00
5/2/83	Dillon's Hair Designs	Ann Arbor, MI	Y	111.96
2/ /84	M. Thimmes	Foster City, CA	Y	209.70
10/11/83	Howard Fong	Ridgewood, MD	Y	101.80
2/ /84	Eminently Hair, Inc.	Lakewood, CO	Y	139.85
2/ /84	Hair Remedies	Holland, MI	Y	133.80
12/2/80	Gary's Place	North Canton, OH	Y	45.95
4/19/83	The Professionals' Reflection	Lakewood, CO	Y	51.50
7/1/83	Garden State Barber Supply	Linden, NJ	Y	467.82
9/27/83	The Studio	Melbourne, Australia	Red	56.95
3/ /82	The Professionals' Reflection	Lakewood, CO	Red	72.00
			Total	\$5,799.42

The documents reviewed are, as submitted by petitioner, enclosed within four notebook-style folders together comprising Exhibit "10". The individual folders are identified above by their respective colors, to wit, "B" (Blue), "R" (Rust), "Y" (Yellow) and "Red" (Red).